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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1943

No. 1012 89

REPPLIER COAL COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

No. 1013 90

REPPLIER COAL COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF.

TRUMAN HENSON,
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No. 1012

REPPLIER COAL COMPANY,

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No. 1013

REPPLIER COAL COMPANY,

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vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

To the Honorable, the Justices of the Supreme Court of the United States:

Your petitioner, Repplier Coal Company, by Truman Henson, its attorney, prays that writs of certiorari issue to review the judgments of the United States Circuit Court of Appeals for the Third Circuit, entered in the above entitled causes on February 19, 1944.

Opinions Below.

The opinion of the Tax Court of the United States (R. 5) is unreported. The opinion of the Circuit Court of Appeals (R. 22) is reported in 140 Fed. (2d) 554.

Jurisdiction.

The judgments of the Circuit Court of Appeals were entered on February 19, 1944 (R. 29). The jurisdiction of the Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

The Questions Presented.

1. Whether, for income and declared value excess profits tax purposes, the petitioner, a coal mining corporation, claiming percentage depletion, was entitled to deduct, as an ordinary and necessary expense, the cost of a mine tunnel which served only to maintain, and not to increase, the petitioner's established annual output of coal, and which was driven long after the petitioner's mine had passed the development stage.

2. Whether the Circuit Court of Appeals erred in holding and deciding that the decision of the Tax Court on the foregoing question was final and not subject to review by the Circuit Court of Appeals.

3. Whether, for purposes of determining net income from a mining property within the meaning of Section 114 (b) (4) of the Revenue Acts of 1934 and 1936, the petitioner's cost of miners' labor was any more than the wages actually paid such miners, plus the cost to petitioner of miner's supplies furnished them by petitioner, at fixed charges to be deducted from wages, pursuant to petitioner's contract with the Miners' Union, where the cost to the petitioner

of such supplies was less than the charges so made therefor.

4. Whether the Circuit Court of Appeals erred in holding and deciding that the decision of the Tax Court on the foregoing question was final and not subject to review by the Circuit Court of Appeals.

5. Whether, where in prior years both the petitioner and the Commissioner of Internal Revenue, mistakenly, as a matter of local real estate law, assumed that petitioner's plant, which was located on leased lands, would pass from petitioner upon the expiration of the then existing leases, and, in consequence, the petitioner erroneously claimed, and the Commissioner erroneously failed to disallow, accelerated depreciation which the Tax Court found to have been excessive, the petitioner's depreciation base should be reduced by any more of such excessive depreciation for such prior years than the amount thereof which served to reduce petitioner's taxes.

6. Whether the Circuit Court of Appeals erred in failing to hold and decide that the decision of the Tax Court on the foregoing question was final and not subject to review by the Circuit Court of Appeals.

Statement.

This case involves federal income tax for the calendar years 1935 and 1936, and declared value excess profits tax for the year 1936.

Since 1922, the petitioner, a Pennsylvania corporation, has been and still is, engaged in mining and selling coal in the Commonwealth of Pennsylvania, primarily on leased land (R. 6, 7, 8). The petitioner's mine had passed the development stage long prior to 1936 and its output had been established at a little over 300,000 tons per year (R. 18).

In 1936, the petitioner drove a mine tunnel at a cost of $86,394.03, which made available 394,000 tons of coal (of which 5,659 tons were produced and sold in 1936) and which served substantially to maintain, but not to increase, the established annual output (R. 10, 18).

Petitioner's method of accounting for such expenditures was to set them up as deferred expense and spread the deduction over the period of the production and sale of the coal. On its return for 1936, the petitioner deducted one-tenth of the cost of the tunnel, but if that cost were to be spread over the coal made available for production, according to the amount thereof produced in each year, the amount allocable to 1936 would be $1,240.19 (R. 10, 15, 18). The Tax Court decided the petitioner was not entitled to any deduction for the cost of the tunnel, because the petitioner had elected to take percentage depletion (R. 15, 16), and the Circuit Court of Appeals affirmed on the ground that the decision of the Tax Court was final and not subject to review (R. 24, 25).

Under its contract with the Miners' Union, the petitioner was obligated to furnish dynamite and miner's supplies and to rent miner's lamps to its miners at fixed charges which were to be deducted from the wages which would otherwise have been payable (R. 9, 19). Such supplies cost the petitioner less than the deduction so made from wages on that account (R. 9, 19). The petitioner claimed depletion on the percentage basis (R. 10, 19). Under the statute, deductible percentage depletion is fixed at five per centum of gross income, but not more than fifty per centum of net income, from the property.[1] The Commissioner of Internal Revenue reduced net income from petitioner's property, and

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[1] Sec. 114 (b)(4), Revenue Act of 1934, C. 277, 48 Stat. 680 and Sec. 114 (b)(4), Revenue Act of 1936, C. 690, 49 Stat. 1648, infra, Appendix, p. 22.

thereby reduced the deduction for depletion, in 1935 and 1936, by asserting that petitioner's cost of miners' labor was the gross amount of wages which would have been (but were not in fact (R. 10, 19)) paid to miners, had not the supplies aforesaid been furnished and charged at the contract prices. The Tax Court upheld the Commissioner's determination (R. 14, 15). The Circuit Court of Appeals affirmed on the ground that the decision of the Tax Court was final and not subject to review (R. 26).

The leases of the lands upon which petitioner conducted its mining operations and on which its plant was located were acquired in 1922 and one of them was to expire in 1932 and the other in 1934. Petitioner constructed its New Castle plant and railroad siding in the years 1925 and 1926 (R. 7). During the years 1930 through 1934, the petitioner claimed largely accelerated depreciation on its returns, upon the basis that the plants should be written off during the remaining terms of the leases, which did not contain renewal clauses. The Commissioner did not disturb or adjust the said returns for the years 1930 to 1934, inclusive, except for a minor reduction of depreciation for 1930 (R. 8). In his deficiency notice, the Commissioner disallowed all depreciation on petitioner's plant for the taxable years 1935 and 1936 except on minor additions made during the years 1935 and 1936, upon the ground that petitioner's depreciation base had theretofore been exhausted by "allowable" depreciation.

The Tax Court held that writing the plants off over the terms of the original leases was erroneous, for while, as stated, neither lease contained a renewal clause, the leases contained provisions recognizing that the plants and improvements were to remain petitioner's property upon termination, and such would have been the result under the law of the Commonwealth of Pennsylvania even had the

leases been silent upon the point (R. 9, 11, 12, 13). While the petitioner had no assurance the leases would be renewed, the fact is that both leases were in fact renewed and the petitioner has uninterruptedly operated, and is still operating, under them and has uninterruptedly continued the owner of and in possession of the plants and improvements, which are still in use by it (R. 8, 9).

It was stipulated, and the Tax Court found as a fact, that the useful physical lives of the plants and improvements were twenty years from time of construction, and the Tax Court also found that a reasonable allowance for exhaustion, wear and tear, and the allowable rate of depreciation, for petitioner's New Castle plant and siding was at all times only five per centum per annum, which was very much less than the accelerated depreciation claimed on petitioner's returns for the years 1930 to 1934, inclusive, as aforesaid (R. 8, 9). During the last named period the petitioner sustained large losses (R. 8). It did reap some benefit in some years from the excess of the claimed depreciation over the five percentum per annum which was properly allowable; and petitioner makes no claim that its depreciation base should not be reduced by the full amount of claimed depreciation of which it received benefit. The petitioner, however, did not receive any advantage from a large part of the excess of the claimed depreciation over that which was allowable (R. 8).

The Tax Court adjusted petitioner's depreciation base under Section 113 (b)(1)(B) of the statute and restored to the petitioner's depreciation base of its New Castle plant and siding so much of the excessive depreciation, which the petitioner erroneously claimed and the Commissioner erroneously failed to disallow, which did not result in any advantage to the petitioner or in any detriment to the Government (R. 13). The Circuit Court of Appeals reversed

the Tax Court on the authority of this Court's recent decision in *Virginian Hotel Corp.* v. *Helvering,* 319 U. S. 523.

Reasons for Granting the Writ.

1. The Court below, in holding and deciding that the petitioner's cost of driving a mine tunnel, which served only to maintain and not to increase, its established output, was not deductible as an ordinary and necessary operating expense, either in the year the tunnel was driven and paid for, or ratably, over the production of the coal, because of petitioner's having claimed percentage depletion under Section 114 (b)(4) of the Revenue Act of 1936, has rendered a decision conflicting in principle with the decisions of the Circuit Courts of Appeals for the Ninth, Fifth and Fourth Circuits in *Guanacevi Mining Co.* v. *Commissioner* (C. C. A. 9), 127 Fed. (2d) 49, 51; *U. S.* v. *Roden Coal Co.* (C. C. A. 5), 39 Fed. (2d) 425, and *Marsh Fork Coal Co.* v. *Lucas* (C. C. A. 4), 42 Fed. (2d) 83, in both of which it is stated that such costs are deductible expenses.

2. On the same point, the Court below has decided an important question of federal income tax law which we believe has not been, but should be, settled by this Court.

3. On the same point, the Court below appears to have decided a question of great public importance, of vital interest to the whole coal and metal mining industry in a way which is contrary to the published ruling, the regulations and the longstanding practice of the Treasury Department, contrary to the weight of authority and contrary to the interpretation to be accorded the statute because of repeated re-enactment in the light of the ruling, regulations, practice and authorities mentioned.

Guanacevi Mining Company v. *Commissioner, supra;*

Marsh Fork Coal Company v. *Lucas, supra;*

Enterprise Coal Company v. *Phillips* (C. C. A. 3), 84 Fed. (2d) 565, affirmed 12 Fed. Supp. 49;
Little War Creek Coal Co. v. *U. S.* (C. C. A. 4), 104 Fed. (2d) 483, affirming 25 Fed. Supp. 764;
U. S. v. *Roden Coal Co.* (C. C. A. 5), 39 Fed. (2d) 425;
Norris & Montgomery "Uniform Classification of Accounts for Anthracite Coal Operators" (1919), p. 12;
W. B. Reed "Bituminous Coal Mining" (1922), p. 201;
C. E. Mengel "Anthracite Production Costs," Bulletin of National Association of Cost Accountants, April 15, 1941;
G. C. M. 13954, C. B. XIII-2, 66;
Regulations 45, 1920 Edition, Article 222 (a);
Regulations 62, Article 222 (a);
Regulations 65, Article 224 (a);
Regulations 69, Article 222;
Regulations 74, Article 242;
Regulations 77, Articles 235 and 221(h);
Regulations 86, Articles 23(m)-15 and 23(m)-1 (h);
Regulations 94, Articles 23(m)-15 and 23(m)-1 (h).

4. In holding and deciding that the decision of the Tax Court on this point was final and not subject to review by the Circuit Court of Appeals, the Court below has decided an important question of federal income tax law in a way which, it is submitted, is in conflict with the applicable decisions of this Court, including *Helvering* v. *American Dental Co.*, 318 U. S. 322, and *Dobson* v. *Commissioner of Internal Revenue*, — U. S. —, 64 S. Ct. 239, 88 L. E. Ad. Op., p. 179, petition for rehearing denied — U. S. —, 64 S. Ct. 495, 88 L. E. Ad. Op., p. 459. The decision of the Tax Court on the point, it is submitted, was the decision of a question of law, or, at least, of a mixed question of law and fact, which was subject to review, and should have been reviewed, by the Circuit Court of Appeals.

5. In holding and deciding that the petitioner's cost of labor, for purposes of determining net income from petitioner's mining property within the meaning of Section 114 (b)(4) of the Revenue Acts of 1934 and 1936, was any more than the amount of wages actually paid, plus the cost to petitioner of miner's supplies furnished, the Court below has decided a question of federal income tax law in a way conflicting in principle with extant analagous authority.

S. S. T. 138, Cumulative Bulletin, 1937-1, p. 442.

S. S. T. 326, Cumulative Bulletin, 1938-2, p. 325.

Commissioner's letter, March 24, 1937, noted at Para. 5203.341, Vol. 1, C. C. H. Unemployment Insurance Service.

UCD release, Pennsylvania Unemployment Compensation Law, Case No. 37 (1937), Vol. 5, C. C. H. Unemployment Insurance Service, Para. 1201.02.

Appeal No. B-44-5-RH-112 (12-7-42), idem, para. 1201.02.

6. In holding and deciding that the decision of the Tax Court on this point was final and not subject to review by the Circuit Court of Appeals, that Court decided a question of federal income tax law in a way which, it is submitted, is in conflict with the applicable decisions of this Court, including *Helvering* v. *American Dental Co.*, supra, and *Dobson* v. *Commissioner of Internal Revenue*, supra. The decision of the Tax Court on the point, we urge, was the decision of a question of law, or, at least, of a mixed question of law and fact, which was subject to review, and should have been reviewed, by the Circuit Court of Appeals.

7. The Court below held that the depreciation point in this case was governed by the decision of this Court in *Virginian Hotel Corp.* v. *Helvering,* supra.

In the *Virginian Hotel* case, this Court held that, on the facts in that case, depreciation theretofore claimed and not disallowed was "allowed" irrespective of whether any "tax benefit" accrued to the taxpayer, citing *Helvering* v. *State-Planters Bank & T. Co.*, (C. C. A. 4), 130 Fed. (2d) 44, which was a "bad debt" decision that whether a deduction was "allowed" did not depend upon whether a "tax benefit" thereby accrued. In the case of *Dobson* v. *Commissioner*, supra, however, this Court expressly disapproved the "bad debt" cases of which *Helvering* v. *State-Planters Bank & T. Co.*, supra, was an example. With great respect it is suggested that, in view of the situation just referred to and the division of this Court in the case of *Bessie P. Douglas* v. *Commissioner of Internal Revenue*, No. 131, October Term, 1943, decided May 15, 1944, unofficially reported in C. C. H. United States Supreme Court Bulletin, Vol. 4, No. 26, p. 1319, it may not be amiss for this petitioner to pray that this Court will review this case and, to the extent it may fall within the ambit of the *Virginian Hotel* case, consider whether the latter decision expresses the present views of this Court.

If the *Virginian Hotel* case is to be regarded as expressing the present thought of this Court, it is suggested that the instant case may not fall within the *Virginian Hotel* decision, in that it does not appear from the opinion in that case that the taxpayer therein urged (as was, and is, urged by the petitioner herein), that the Commissioner should not be heard to allege his own failure to disallow unallowable depreciation, as the basis for depriving the petitioner of a part of its depreciation base, where both the petitioner and the Commissioner were acting under the same mistake of law, and neither the Commissioner nor the Government's collection of its taxes was prejudiced.

Further, in this case, it was expressly found by the Tax Court that the depreciation claimed in prior years was

actually excessive and unallowable, and that such excessive depreciation was not "allowed" to any extent in excess of the amount thereof which served to offset taxable income. It is respectfully suggested that this case should be reviewed by this Court in order to settle whether, where such findings have been made by the Tax Court, those findings are final and not subject to review under this Court's decision in the *Dobson* case, supra.

In view of the great and widespread importance of this question, it is respectfully requested that this Court review this case.

Wherefore, your petitioner respectfully prays that this petition for writs of certiorari be granted.

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Dated: New York, N. Y. May 17, 1944.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1943

No. 1012

REPPLIER COAL COMPANY,
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COMMISSIONER OF INTERNAL REVENUE.

No. 1013

REPPLIER COAL COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

BRIEF IN SUPPORT OF PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

The Questions Presented.

The questions presented are stated in the petition.

Statutes and Regulations Involved.

The statutes and regulations involved are set out in the Appendix, pp. 24-28.

Statement.

The facts are stated in the petition.

Specifications of Errors to Be Urged.

The Court below erred:

1. In holding that the question of whether the cost of a mine tunnel (to maintain the established production of a mine long past the development stage) is a currently deductible expense, is a question of fact upon which the decision of the Tax Court was final.

2. In holding that because petitioner claimed percentage depletion, it should be denied the right to deduct, as an ordinary and necessary operating expense, the cost of a mine tunnel to maintain the established output of its mine which was long past the development stage.

3. In failing to hold that the cost of a mine tunnel to maintain the established output of petitioner's mine, which was long past the development stage, is a currently deductible expense.

4. In sustaining the decision of the Tax Court upon the point.

5. In holding that, in determining net income from petitioner's mining property within the meaning of Section 114 (b) (4) of the Revenue Acts of 1934 and 1936, the question of whether petitioner's cost of miners' labor was (a) the amount of money paid plus the contract price at which the petitioner furnished miner's supplies to its miners, or (b) the amount of money paid by petitioner plus the cost to it of such supplies, was a question of fact upon which the decision of the Tax Court was final.

6. In failing to hold that, in determining such net income from said mining property, petitioner's cost of miners'

labor was no more than the amount of money it paid its miners plus the cost to it of said supplies.

7. In sustaining the decision of the Tax Court upon the point.

8. In failing to hold that where, acting under a mutual mistake of law, the petitioner erroneously claimed, and the Commissioner erroneously failed to disallow excessive depreciation in prior years, the Commissioner should not be heard to urge his own error as the basis for reducing petitioner's depreciation base on account of such excessive depreciation, to any extent in excess of the benefit derived by petitioner from such error.

9. In holding that petitioner's depreciation base should be reduced by depreciation theretofore claimed to any extent beyond the amount thereof found allowable by the Tax Court, plus the amount thereof which offset taxable income.

10. In failing to hold that the decision of the Tax Court on the point was final and not subject to review.

11. In failing to sustain the decision of the Tax Court on the point.

ARGUMENT.

I.

The Decision Below That the Questions of (a) Whether the Cost of a Tunnel to Maintain Mine Output Is a Currently Deductible Expense, and (b) Whether the Cost of Miners' Labor Was the Actual, or a Theoretical, Amount Thereof, Are Questions upon Which the Determination of the Tax Court Is Final, Appears to Conflict With the Applicable Decisions of This Court.

To this petitioner, it appears that the Court below misinterpreted this Court's recent decision in *Dobson* v. *Com-*

missioner of Internal Revenue, — U. S. —, 64 S. Ct. 239, 88 L. Ed. Ad. Op. 179, petition for rehearing denied — U. S. —, 64 S. Ct. 475, 88 L. Ed. Ad. Op., p. 459. As construed by us, the doctrine of that decision is that the question of whether a series of acts amounts to one single, or several separate, transactions, for tax purposes, is a question of fact upon which a decision of the Tax Court is final. We do not understand the *Dobson* case to have overruled, either expressly or by implication, either this Court's numerous decisions that determinations of the Tax Court on matters of law are reviewable, or the recent decision of this Court in *Helvering* v. *American Dental Co.*, 318 U. S. 322, in which it was said, pp. 330, 331, "We do not feel bound by the finding of the Board because it reached its conclusions, in our opinion, upon an application of erroneous legal standards. Section 22 (b) (3) exempts gifts. This does not leave the Tax Court of the United States free to determine at will or upon evidence and without judicial review the tests to be applied to facts to determine whether the result is or is not a gift." The question presented in the *American Dental* case was a question of law, upon which a decision of the Tax Court was subject to review; and, in our case, the question of whether the cost of the tunnel was deductible as an ordinary and necessary operating expense was, we submit, also a question of law which the Court below should have reviewed and corrected. There was no question of fact. The facts were stipulated. The only question was the question of law of whether the cost of a mine tunnel to maintain production was so deductible. The Tax Court did not purport to decide the question as a question of fact. It held that the expenditure was not deductible because the Tax Court thought it involved a "double deduction" and "deductions for depletion on both the percentage and cost bases." That decision, we submit, was a reviewable decision of law.

In like manner, all the facts concerning the cost of miners' labor, to be deducted in arriving at the percentage depletion limitation, were stipulated; and the only question was the question of law as to whether a theoretical, or the actual cost of such labor was so to be deducted in arriving at net income from the property within the meaning of Section 114 (b)(4) of the Revenue Acts of 1934 and 1936. While, on this point of the cost of labor, the Tax Court did state, "The situation is the same as if the miners had received their entire wages in cash and had then purchased the supplies," and "the essential nature of the situation * * * was * * * the payment of wages in full and the realization of a profit upon a distinct and separate transaction," that was not a finding of fact, but a conclusion of law. The fact was just the opposite. The miners did not receive their entire wages in cash, but received the same partly in cash and partly in supplies which had cost the petitioner less than the contract prices at which they were furnished to the miners.

We urge that the decision below erroneously interprets this Court's decision in the *Dobson* case on an important and fundamental question of federal income tax law; and that the decision below should, therefore, be reviewed by this Court.

II.

The Decision Below, That the Cost of a Mine Tunnel to Maintain the Output of a Mine Long Past the Development Stage Is Not Currently Deductible, Is the Decision of an Important Question of Income Tax Which Has Not Been, But Should Be, Passed upon by This Court; It Conflicts in Principle With the Decisions of Three Other Circuit Courts of Appeals; and It Is Contrary to the Weight of Authority, the Published Ruling, the Regulations and the Practice of the Treasury Department, and Contrary to the Interpretation to Be Accorded the Statute Due to Repeated Re-enactment in the Light of the Authorities and Practice Mentioned.

On the issue concerning the deductibility of the cost of the tunnel, this case presents the only decision of which we are aware which varies from the long established rule that an expenditure made to maintain (and not to attain or increase) production, and where the mine has passed the development stage, is a deductible expense either in the year incurred or ratably over coal or ore made available.

The question of the current deductibility of such costs is important and recurrent throughout the mining industry. Mine tunnels, rock gangways and similar works are constantly becoming necessary in the operation of producing mines in order to reach the diminishing mineral and maintain production. So far as we have been able to find, this Court has never passed upon the point; but now that this case has appeared and announced a rule in contravention of that which has been followed and applied for many years, it is submitted that this Court should settle the matter.

The decision below enunciates a doctrine which is in direct conflict with the rule as laid down by three other Circuit Courts of Appeals in the only cases (except a prior case in

which the Circuit Court of Appeals for the Third Circuit rendered a decision at variance with its decision herein) of which we are aware, in which a Circuit Court of Appeals has considered the subject. Although in *Guanacevi Mining Company* v. *Commissioner*, 127 Fed. (2d) 49, the Circuit Court of Appeals for the Ninth Circuit held that the expenditure there in question was not deductible, that result was reached because it appeared that the tunnel under consideration in that case was built to *attain* an intended production, the mine not having passed the development stage, and the Court said, p. 51:

> "The teaching of the opinions in Marsh Fork Coal Co. v. Lucas, 4 Cir., 42 F. 2d 83, 85, 86, and Enterprise Coal Co. v. Phillips, D. C., Pa., 12 F. Supp., 49, 50, 51, affirmed 3 Cir., 84 F. 2d 565, impress upon us that if an expenditure is made to *attain* an intended output, it is properly chargeable to capital as a cost of development; if the expenditure is made to *maintain* an output, it is properly chargeable to operating expense."

In the *Marsh Fork Coal Co.* case, cited in the extract above, and in *Little War Creek Coal Co.* v. *U. S.*, 25 Fed. Supp. 764; aff'd 104 Fed. (2d) 483, the Circuit Court of Appeals for the Fourth Circuit decided that if an expenditure is made to maintain output, it is properly chargeable to operating expense. Accord, *U. S.* v. *Roden Coal Co.*, (C. C. A. 5), 39 Fed. (2d) 425, and the same Circuit Court of Appeals which decided the instant case reached a conclusion in harmony with the foregoing cases in *Enterprise Coal Co.* v. *Phillips*, cited in the above quotation from the *Guanacevi Mining Co.* case.

See also:

Norris & Montgomery "Uniform Classification of Accounts for Anthracite Coal Operators" (1919), p. 12.
W. B. Reed "Bituminous Coal Mining" (1922), p. 201.
C. E. Mengel "Anthracite Production Costs", Bulletin

of National Association of Cost Accountants, April 15, 1941.
G. C. M. 13954, C. B. XIII-2, 66.
Regulations 45, 1920 Edition, Article 222 (a).
Regulations 62, Article 222 (a).
Regulations 65, Article 224 (a).
Regulations 69, Article 222.
Regulations 74, Article 242.
Regulations 77, Articles 235 and 221 (h).
Regulations 86, Articles 23(m)-15 and 23(m)-1 (h).
Regulations 94, Articles 23(m)-15 and 23(m)-1 (h).

The provisions of the Revenue Acts concerning the deduction of expenses and depletion have remained substantially unchanged since 1918, except that a provision for percentage depletion first appeared in the Revenue Act of 1932. The latter provision was re-enacted without change in the Revenue Act of 1934 and in the Act here under consideration, to wit, the Revenue Act of 1936. In 1934, after holding conferences with, and receiving the briefs of, representatives of the mining industry, Mr. Justice Jackson, then Assistant General Counsel for the Bureau of Internal Revenue, issued G. C. M. 13954, C. B. XIII-2, 66, in which he reviewed the Treasury Department practice for the preceding fifteen years, and stated the considered position of his office, in part, as follows (p. 72):

> "In the case of mines there has never been a definite pronouncement in the Bureau regulations since Regulations 45, original 1919 edition, to the effect that capitalized development costs after the mine has reached the producing stage shall be charged to the capital account recoverable through depletion. On the contrary, for a considerable period (article 222 (a) of Regulations 45 (1920 edition) and Regulations 62 and article 224 (a) of Regulations 65) it was definitely provided that such development costs should be treated as

deferred operating expenses and deducted as such in the years to which applicable. It is true that beginning with Regulations 69 this express rule has been omitted from the Bureau regulations, but it appears to be far from certain that a practice to the contrary was established after such omission. Since Regulations 69 the Bureau regulations in reference to the capitalization of mine development costs have provided only that all expenditures during the development stage shall be charged to the capital account recoverable through depletion. As has been indicated heretofore, the definition of the term 'operating cost' in article 206 (d) of Regulations 69 (and see article 226 (d), Regulations 74, and article 227 (d), Regulations 77) has been left in such form as to imply that such term includes all costs which are not expressly required to be charged to the depletion account. * * *

"Accordingly, it is the opinion of this office that the capital to be recovered through depletion allowance under the general rule set forth in section 114 (b) 1 of the Revenue Acts of 1932 and 1934 which the percentage depletion allowances under such Acts are to be taken in lieu of, is composed in part of the capitalized development expenditures during the development stage of the mine; and that so-called capitalized development costs after the mine has reached the producing status should not be treated as capital charges recoverable through depletion, but as operating expenses deductible in the year in which the ore benefited by such expenditures is produced and sold. * * *"

Following this ruling, the Revenue Act of 1936 was enacted without any change from the Revenue Act of 1934, which would be material to this issue.

We submit that the Court below erred on this important question and that this Court should review that decision.

III.

It Is Respectfully Suggested That This Court Should Review the Decision Below and Settle Whether the Rule Laid Down by It in the Virginian Hotel Case Is to Be Deemed Modified by This Court's Subsequent Decision in the Dobson Case.

In the petition herein, the seventh of the reasons expressed for granting the writs outlines the doubts which, it is believed, may exist in the minds of taxpayers as to whether, in view of this Court's disapproval of the "bad debt" cases in its decision in the *Dobson* case, the prior decision in the *Virginian Hotel* case, (which apparently approved, if it did not rely upon, the "bad debt" cases), represents the present views of this Court.

In addition, the Tax Court having found herein that a part of the depreciation claimed in prior years was in fact excessive, and having found that such excessive depreciation had not been "allowed", except in part, we submit that this Court should settle whether the doctrine of the *Dobson* case is to be construed as hereinabove suggested by us under Point I, or whether, under that doctrine, the decision of the Tax Court on the depreciation point in this case should not have been held to be final by the Court below.

Further, the excessive depreciation claimed herein in prior years and not disturbed by the Commissioner, was based upon a mistake of law mutual to the petitioner and the Commissioner. It is believed that other cases may arise in which, as here, it may be urged that the Commissioner should not be heard to plead his own dereliction of duty, in failing to disallow unallowable depreciation, as a basis for penalizing the taxpayer to any extent beyond whatever benefit the taxpayer may have derived from the error. And we respectfully request this Court to decide whether such a

defense is available to a taxpayer and sufficient to remove from the compass of the rule of the *Virginian Hotel* decision, a case which might otherwise fall within it.

For the foregoing reasons, and particularly in view of the widespread importance of this depreciation issue, it is most respectfully suggested that this Court should review this case and resolve the doubts which have been mentioned.

Conclusion.

It is respectfully submitted that the petition for writs of certiorari herein should be granted.

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APPENDIX.

Revenue Act of 1934, C. 277, 48 Stat. 680 and
Revenue Act of 1936, C. 690, 49 Stat. 1648:

Sec. 23.

"In computing net income there shall be allowed as deductions:

"(a) Expenses.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity."

"(m) Depletion.—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this subsection for subsequent taxable years shall be based upon such revised estimate. In the case of leases the deductions shall be equitably apportioned between the lessor and lessee. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with

the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each. (For percentage depletion allowable under this subsection, see section 114 (b), (3) and (4).)"

Sec. 113. Adjusted basis for determining gain or loss.

* * * * * * *

(b) Adjusted Basis.—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) General Rule.—Proper adjustment in respect of the property shall in all cases be made—

* * * * * * *

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws. * * *

* * * * * * *

Sec. 114. Basis for depreciation and depletion.

(a) Basis for Depreciation.—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property.

(b) Basis for Depletion.—

* * * * * * *

"(4) Percentage Depletion for Coal and Metal Mines and Sulphur.—The allowance for depletion under section 23 (m) shall be, in the case of coal mines, 5 per centum, in the case of metal mines, 15 per centum, and, in the case of sulphur mines or deposits, 23 per centum, of the gross income from the property during the taxable year, excluding

from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property. A taxpayer making his first return under this title in respect of a property shall state whether he elects to have the depletion allowance for such property for the taxable year for which the return is made computed with or without regard to percentage depletion, and the depletion allowance in respect of such property for such year shall be computed according to the election thus made. If the taxpayer fails to make such statement in the return, the depletion allowance for such property for such year shall be computed without reference to percentage depletion. The method, determined as above, of computing the depletion allowance shall be applied in the case of the property for all taxable years in which it is in the hands of such taxprayer, or of any other person if the basis of the property (for determining gain) in his hands is, under section 113, determined by reference to the basis in the hands of such taxpayer either directly or through one or more substituted bases, as defined in that section. The above right of election shall be subject to the qualification that this paragraph shall, for the purpose of determining whether the method of computing the depletion allowance follows the property, be considered a continuation of section 114 (b) (4) of the Revenue Act of 1934, and as giving no new election in cases where such section would, if applied, give no new election."

(The last sentence appears only in the Revenue Act of 1936).

Treasury Regulations 86 under the Revenue Act of 1934 and Treasury Regulations 94 under the Revenue Act of 1936:

Art. 23(m)-1 (h):

"(h) 'Net income of the taxpayer (computed without allowance for depletion) from the property,' as used in section 114(b) (2), (3), and (4) and articles 23(m)-1 to

23(m)-28, inclusive, means the 'gross income from the property' as defined in paragraph (g) less the allowable deductions attributable to the mineral property upon which the depletion is claimed and the allowable deductions attributable to the processes listed in paragraph (g) in so far as they relate to the product of such property, including overhead and operating expenses, development costs properly charged to expense, depreciation, taxes, losses sustained, etc., but excluding any allowance for depletion. Deductions not directly attributable to particular properties or processes shall be fairly allocated. To illustrate: In cases where the taxpayer engaged in activities in addition to mineral extraction and to the processes listed in paragraph (g), deductions for depreciation, taxes, general expenses, and overhead, which can not be directly attributed to any specific activity, shall be fairly apportioned between (1) the mineral extraction and the processes listed in paragraph (g) and (2) the additional activities, taking into account the ratio which the operating expenses directly attributable to the mineral extraction and the processes listed in paragraph (g) bear to the operating expenses directly attributable to the additional activities. If more than one mineral property is involved, the deductions apportioned to the mineral extraction and the processes listed in paragraph (g) shall, in turn, be fairly apportioned to the several properties, taking into account their relative production."

Art. 23(m)-15:

"Allowable capital additions in case of mines.—(a) All expenditures in excess of net receipts from minerals sold shall be charged to capital account recoverable through depletion while the mine is in the development stage. The mine will be considered to have passed from a development to a producing status when the major portion of the mineral production is obtained from workings other than those opened for the purpose of development, or when the principal activity of the mine becomes the production of developed ore rather than the development of additional ores for mining.

"(b) Expenditures for plant and equipment and for replacements, not including expenditures for maintenance and for ordinary and necessary repairs, shall ordinarily be charged to capital account recoverable through depreciation. Expenditures for equipment (including its installation and housing) and for replacements thereof which are necessary to maintain the normal output solely because of the recession of the working faces of the mine, and which (1) do not increase the value of the mine, or (2) do not decrease the cost of production of mineral units, or (3) do not represent an amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made, shall be deducted as ordinary and necessary business expenses."

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In the Supreme Court of the United States

OCTOBER TERM, 1944

Nos. 89–90

REPPLIER COAL COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the Tax Court of the United States (R. 5–16) is unreported. The opinion of the circuit court of appeals (R. 22–28) is reported in 140 F. 2d 554.

JURISDICTION

The judgments of the circuit court of appeals were entered on February 19, 1944 (R. 28–29). The petition for writs of certiorari was filed on May 19, 1944. The jurisdiction of this Court is

invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the cost of constructing a major tunnel for the purpose of opening a new coal mining area may be treated by the coal company petitioner as a current business expense under Section 23 (a) of the Revenue Act of 1936 or must be treated as a capital expenditure recoverable through depletion allowances.

2. Whether profits realized by petitioner in selling supplies to its employees constituted "income from the property" as contemplated in Section 114 (b) (4) of the Revenue Act of 1934.

3. Whether depreciation deductions "allowed" in years prior to the ones here involved exhausted the cost bases of the assets, under Section 113 (b) (1) (B) of the Revenue Act of 1934.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and Regulations are set forth in the Appendix, *infra,* pp. 13–17.

STATEMENT

On August 14, 1922, petitioner acquired by assignment a coal lease, which was to expire on July 31, 1934. Upon the property covered by this lease, petitioner constructed a plant, hereinafter termed the New Castle Plant. Construction was begun in the fall of 1925 and completed in 1926

at a cost of $912,336.11. Petitioner also constructed a railroad siding on this leasehold during 1926 at a cost of $12,139.91. (R. 6–7.)

The useful physical life of the mining plant was 20 years at the time of construction. A new lease covering the tract, upon which petitioner had constructed the New Castle Plant, was granted to petitioner on August 1, 1934. The new lease was on a month-to-month basis, terminable by either party upon 30 days' notice. There have been no notices of termination. Until the execution of the lease on August 1, 1934, petitioner had no assurance that it would be executed. The New Castle Plant was constructed by petitioner without consideration of whether the then existing lease would be renewed. Accordingly, petitioner proceeded to claim depreciation deductions based upon the remaining life of the original lease (1930 return), and in the years to and including 1934 claimed as deductions the full amount of the cost basis. The deductions so claimed were not materially disturbed by the Commissioner. The petitioner received no tax benefit as to part of the deductions. (R. 8.)

In the notice of deficiency, the Commissioner disallowed depreciation of $99,108.10 for the year 1935 and $31,204.25 for the year 1936 with the explanation, "Excessive deduction for depreciation disallowed, because the assets acquired in previous years have been fully depreciated by

allowable deductions claimed in prior years" (R. 9).

A reasonable allowance for exhaustion, wear and tear of the New Castle Plant and the railroad siding during the years 1930 to 1934, inclusive, was five percent per annum of their respective costs (R. 9).

Under the petitioner's contract with the Miners' Union, petitioner was obliged to furnish to its miners dynamite and miners' supplies, and to rent them mine lamps at fixed charges to be deducted from wages payable. Petitioner's profit on these items was $10,156.25 in 1935 and $9,203.84 in 1936. On each of its returns for the years 1930 to 1934, inclusive, income from the sale of dynamite and supplies and from lamp rentals was listed as an item separate from its gross receipts from the production and sale of coal. (R. 9–10.)

Petitioner duly elected to deduct depletion on the percentage basis for the taxable years 1935 and 1936. The Commissioner excluded from income from the mining property the profit derived by petitioner on selling and renting mining supplies to its employees. At the same time, in computing net income from the mining property, the Commissioner deducted as miners' wages the full amount to which they were entitled under the terms of their contracts, without deduction therefrom on account of the charges made for the supplies sold or rented to the miners nor for the

profit realized by petitioner on such sales and rentals. (R. 10.)

During the year 1936, petitioner constructed a certain mine tunnel at a cost of $86,394.03, thereby making available for production 394,000 tons of coal. Of the coal so made available, petitioner produced and sold 5,659 tons in the year 1936. Petitioner's mine had long since passed the development stage. In the notice of deficiency, the Commissioner allowed petitioner percentage depletion for the year 1936 based upon income from its mining properties, which included income derived from the coal produced as a result of the construction of the tunnel. (R. 10.)

The Tax Court concluded that (R. 11) while deductions for depreciation taken on the petitioner's returns for the years prior to 1935 exhausted the cost basis of the assets, the deductions were not "allowed" (sec. 113 (b) (1) (B) of the Revenue Acts of 1934 and 1936) since they did not offset taxable income in full; that since the depreciation should be based upon the useful life of the properties rather than upon the limited life of the lease, the excessive deductions were not "allowable." As to this issue, the court below reversed (R. 28).

With respect to the profits derived by the petitioner from the furnishing of supplies to the miners, the Tax Court concluded that (R. 14–15) this profit could not be treated as "net income from the property" within the meaning of the

statute fixing the limit upon depletion allowances. On the issue involving the construction cost of the new tunnel, the Tax Court concluded (R. 16) the expenditure was of a capital nature and its cost must be recovered through depletion allowances and could not be deducted as a current business expense. As to these two issues, the court below affirmed (R. 25–26).

ARGUMENT

1. The decision of the court below that (R. 24) there was nothing in the statute or the Regulations which conflicts with the Tax Court's conclusion that the tunnel expenditure was of a capital nature and could not be deducted as a current business expense is not in conflict with *Guanacevi Mining Co.* v. *Commissioner,* 127 F. 2d 49 (C. C. A. 9th); *United States* v. *Roden Coal Co.,* 39 F. 2d 425 (C. C. A. 5th); and *Marsh Fork Coal Co.* v. *Lucas,* 42 F. 2d 83 (C. C. A. 4th), which are relied upon by the petitioner (Pet. 7).

In the *Guanacevi Mining Co.* case, the court fully sustained the position of the Government to the effect that the construction of the new tunnels and the installation of the new machinery and methods must be regarded as part of the development of what was in effect a new mine. The decision there is consonant with our position here, though it is not decisive of the issue here for either party.[1] We do not here

[1] *Enterprise Coal Co.* v. *Phillips,* 84 F. 2d 565 (C. C. A. 3d) (Pet. 19), occupies a similar posture.

contend that the taxpayer's coal mine was in the development stage and that the cost of the tunnel must for that reason be capitalized. Article 23 (m)–15 of Treasury Regulations 86 (Appendix, *infra*, p. 16), specified that many items of expenditure not inherently of a capital nature were to be capitalized if incurred during the development stage. Thus the problem is simplified in cases where it can be shown that the mine is still in the development stage. But the mere fact that the mine has passed the development stage does not entitle the taxpayer to deduct as current expense every type of expenditure. All that the Regulations said (Art. 23 (m)–15) was that certain expenditures "for equipment," necessary to maintain the normal output because of recession of the working face of the mine "and which (1) do not increase the value of the mine," might be deducted as current expenses after the development stage had been passed. But if in fact the expenditure was inherently of a capital nature, as the Tax Court here found, then the statute and the Regulations require that such cost be capitalized.

Other cases have properly held that expenditures for such minor equipment as car wheels, switches, trolley wires, and rails, necessary to maintain normal production after the mine has reached the producing stage, need not be capital-

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ized but may be treated as deductible expenses. On analysis, these cases do not militate against the Government's position here. The reasons given for allowing the deductions in such cases clearly indicate that a contrary decision should be reached in the case at bar. For example, in the *Roden Coal Co.* case, *supra,* the major expenditures were for new car wheels and for enlarging a four-inch water pipe to a six-inch pipe. The trial court specifically found that (39 F. 2d at p. 426) none of such items decreased the cost of producing the coal or added to the value of the coal mine, and that the expenditures were necessary in order to maintain the normal production of the mines, due to the constantly increasing depth of workings.[2] Compare *Blockton Cahaba Coal Co.* v. *United States,* 24 F. 2d 180 (C. C. A. 5th), where the same court said (p. 181):

> Money laid out in the construction of a coal mine to a greater depth is invested capital, just as much as is money spent to add a second story to a building that already is rented at a profit.

The *Marsh Fork Coal Co.* case, *supra,* may be similarly explained, in that the expenditures there involved were for extended trackage and additional mine train equipment, made necessary by

[2] The stipulation here is merely that (R. 18) the established production was not in fact increased materially following the completion of the new tunnel.

the gradual recession of the working area of the mine. Thus, unlike the instant case, the *Marsh Fork* and *Roden Coal* cases fall within the phraseology of Article 23 (M)–15 describing what may be deducted as current business expenses. (See Appendix, *infra*, p. 16.)

The court below was satisfied that the correct rule of law had been applied and that "there certainly was sufficient evidence to justify the Tax Court's treatment of the expenditure as a capital item" (R. 24). Hence there is no occasion to consider the question of the scope of *Helvering* v. *American Dental Co.*, 318 U. S. 322, and *Dobson* v. *Commissioner*, 320 U. S. 489, rehearing denied, 321 U. S. 231[3] (Pet. 8), dealing with the power of courts to review and reverse decisions of the Tax Court.

2. No conflict of authorities is asserted with respect to the holding of the court below that the Tax Court properly computed the petitioner's "income from the property," as contemplated in Section 114 (b) (4) of the Revenue Act of 1934 (Appendix, *infra*, pp. 14–15), which limits depletion deductions to fifty percent of that amount. The Tax Court found (R. 15) that the petitioner was obligated to pay its employees a fixed amount,

[3] Petitioner cites (Pet. 8) the *Dobson* case to show that the Circuit Court of Appeals should have given less weight to the decision of the Tax Court. However, the *Dobson* case seems peculiarly applicable, in the Government's favor, to the circumstances involved here.

and that the essential nature of the situation was the same as if the wages had been paid in full and a profit realized upon a separate phase of the transaction through the sale of supplies to the miners. As used in the statute, the phrase "income from the property" means only income derived from the operation which is depleting that property. Profits derived from selling supplies to miners engaged in that operation, even though a legitimate corporate activity, must be here excluded in view of the obvious purpose of the statute. See *Consumers Natural Gas Co.* v. *Commissioner,* 78 F. 2d 161 (C. C. A. 2d), certiorari denied, 296 U. S. 634. This issue presents no basis for the issuance of the writs.

3. The final ground asserted for the issuance of the writs is obviously without merit. In *Virginian Hotel Corp.* v. *Helvering,* 319 U. S. 523, rehearing denied, 320 U. S. 810,[4] this Court ruled that depreciation is "allowed" within the meaning of Section 113 (b) (1) (B) of the statute when it is claimed by the taxpayer and not opposed by the Commissioner, even though the taxpayer had insufficient net income to enjoy the full tax benefit of the deduction. The petitioner here is in effect asking for a reconsideration of the question (Pet.

[4] See also *Douglas* v. *Commissioner*, Nos. 130–133, October Term, 1943, decided May 15, 1944; *Commissioner of Internal Revenue* v. *Kennedy Laundry Co.*, 133 F. 2d 660 (C. C. A. 7th), certiorari denied, 319 U. S. 770, rehearing denied, 320 U. S. 810.

10). The court below properly concluded that (R. 28) the decision in the *Virginian Hotel* case was controlling on the depreciation issue here and that since the point merely involved the legal effect to be given to the statutory term "allowed," the decision of the Tax Court could to this extent be reversed without violating the principles announced in the *Dobson* case.

In view of the broad basis of the decision in the *Virginian Hotel* case, no material factual distinction can be established. The petitioner claims (Pet. 10) that the excessive depreciation allowances here were based upon a mutual mistake of law. Even if that assertion were true,[5] the result would not be affected for the statute in question is concerned with the fact of allowance rather than the reason for the allowance.

---

[5] Before the Tax Court, the Commissioner contended that even if it be assumed that the petitioner had the legal right to remove the depreciable property from the premises at the expiration of the lease, the property was of such a nature as to have only a salvage value; and that for this reason the accelerated depreciation during the term of the lease was proper under any view of the legal rights of the lessee, and that the depreciation was not only "allowed" but "allowable" as well.

CONCLUSION

The decision below is correct, and there is no conflict of authorities. The petition for writs of certiorari should therefore be denied.

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JUNE 1944.

APPENDIX

The Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *

* * * * *

(m) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. * * *

(n) *Basis for Depreciation and Depletion.*—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

* * * * *

SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) *General Rule.*—In computing net income no deduction shall in any case be allowed in respect of—

* * * * *

(2) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate;

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

* * * * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General Rule.*—Proper adjustment in respect of the property shall in all cases be made—

* * * * *

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws. * * *

* * * * *

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) *Basis for Depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property.

(b) *Basis for Depletion*—

* * * * *

(4) *Percentage Depletion for Coal and Metal Mines and Sulphur.*—The allowance for depletion under section 23 (m) shall be, in the case of coal mines, 5 per centum, in the case of metal mines, 15 per centum,

and, in the case of sulphur mines or deposits, 23 per centum, of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property. * * *

Sections 23 (a), (m), (n); 24 (a) (2); 113 (b) (1) (B); and 114 (a), (b) (4) of the Revenue Act of 1936, c. 690, 49 Stat. 1648, are the same as above.

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 23 (m)–1. *Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements.*—* * *

* * * * *

(*g*) "Gross income from the property" as used in section 114 (b) (3) and (4) and articles 23 (m)–1 to 23 (m)–28, inclusive, means the amount for which the taxpayer sells (*a*) the crude mineral product of the property or (*b*) the product derived therefrom, * * *

(*h*) "Net income of the taxpayer (computed without allowance for depletion) from the property," as used in section 114 (b) (2), (3), and (4) and articles 23 (m)–1 to 23 (m)–28, inclusive, means the "gross income from the property" as defined in paragraph (*g*) less the allowable deductions attributable to the mineral property upon which the depletion is claimed and

the allowable deductions attributable to the processes listed in paragraph (*g*) in so far as they relate to the product of such property, * * *

ART. 23 (m)–15. *Allowable capital additions in case of mines.*—(*a*) All expenditures in excess of net receipts from minerals sold shall be charged to capital account recoverable through depletion while the mine is in the development stage. The mine will be considered to have passed from a development to a producing status when the major portion of the mineral production is obtained from workings other than those opened for the purpose of development, or when the principal activity of the mine becomes the production of developed ore rather than the development of additional ores for mining.

(*b*) Expenditures for plant and equipment and for replacements, not including expenditures for maintenance and for ordinary and necessary repairs, shall ordinarily be charged to capital account recoverable through depreciation. Expenditures for equipment (including its installation and housing) and for replacements thereof, which are necessary to maintain the normal output solely because of the recession of the working faces of the mine, and which (1) do not increase the value of the mine, or (2) do not decrease the cost of production of mineral units, or (3) do not represent an amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made, shall be deducted as ordinary and necessary business expenses.

ART. 24–2. *Capital expenditures.*—Amounts paid for increasing the capital

value or for making good the depreciation (for which a deduction has been made) of property are not deductible from gross income. * * *

ART. 113 (b)–1. *Adjusted basis: General rule.*—* * *

* * * * *

The cost or other basis must also be decreased by the amount of the deductions for exhaustion, wear and tear, obsolescence, amortization, and depletion to the extent such deductions have in respect of any period since February 28, 1913, been allowed (but such decrease shall not be less than the amount of deductions allowable) under the Revenue Act of 1934 or prior income tax laws. The adjustment required for any taxable year or period is the amount allowed or the amount allowable for such year or period under the law applicable thereto, whichever is the greater amount. A taxpayer is not permitted to take advantage in a later year of his prior failure to take any depreciation allowance or of his action in taking an allowance plainly inadequate under the known facts in prior years. The determination of the amount properly allowable shall, however, be made on the basis of facts reasonably known to exist at the end of such year or period. * * *

Articles 23 (m)–1 (g) and (h), 23 (m)–15, 24–2 and 113 (b)–1 of Treasury Regulations 94, promulgated under the Revenue Act of 1936, are the same as above.

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Nos. 89 and 90

Supreme Court of the United States

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REPPLIER COAL COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF OF AMICI CURIAE

F. G. Davidson, Jr.,
Theodore L. Harrison,
J. Donald Rawlings,
W. A. Sutherland,
Amici Curiae.

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MOTION FOR LEAVE TO FILE BRIEF AS AMICI CURIAE

The undersigned respectfully move this Honorable Court for leave to file the annexed brief as amici curiae in the above entitled cause.

Respectfully submitted,

F. G. Davidson, Jr.,
Theodore L. Harrison,
J. Donald Rawlings,
W. A. Sutherland,
Amici Curiae.

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BRIEF FOR AMICI CURIAE

This brief is submitted by the undersigned in support of the petition for certiorari herein to the extent that the petition seeks the review of one issue in which the undersigned are interested on behalf of their several clients. The fact that this brief does not support the petitioner's request that other issues be reviewed is not intended in any way to reflect upon the merits of the other issues as to which clients of the undersigned have no interest.

The petition herein should be granted for the reason that the determination of the Court below is, we submit, contrary to recent decisions of this Court.

From the petition herein it appears that the Tax Court found that the allowable rate of depreciation during petitioner's tax years 1930 to 1934 was substantially less than the amount reported on petitioner's returns for such years. Further, the Tax Court found that petitioner's depreciation base should be adjusted under Section 113 (b)(1)(B) of the

statute by restoring to the petitioner's depreciation base the excessive depreciation [1] reported on the return.

The Circuit Court of Appeals reversed the Tax Court on the authority of this Court's decision in *Virginian Hotel Corp.* v. *Helvering,* 319 U. S. 523 (October Term, 1942, No. 766). In the petition for certiorari herein this Court is requested to review that determination of the Court below.

We urge that the Court grant the petition to review that determination of the Court below for the following reasons:

(1) The decision of the Court below reversing the Tax Court is contrary to this Court's decision in *Dobson* v. *Commissioner,* 320 U. S. 489 (October Term, 1943, No. 266) holding that the determination of the Tax Court on questions of this character should not be disturbed; and

(2) The decision of this Court in *Virginian Hotel Corp.* v. *Helvering,* supra, has been overruled by the decision of this Court in *Dobson* v. *Commissioner,* 320 U. S. 489 (October Term, 1943, No. 266). If this Court did not intend to overrule the *Virginian Hotel* decision in *Dobson* v. *Commissioner,* a most undesirable state of confusion has been created in this very important field of Federal taxation as a result of the decisions by this Court in the *Dobson* case and in *Douglas* v. *Commissioner,* (October Term, 1943, Nos. 130-133).

In the case at bar the Tax Court found that the proper rate of depreciation was substantially less than that used by the taxpayer in its returns for the years 1930-1934. The Tax Court further found that the depreciation reported on the return in excess of that properly allowable should be restored to the taxpayer's basis for computing depreciation in later years to the extent that such excess had not served to reduce the petitioner's taxes in the years mentioned.

[1] Whenever the term "excessive depreciation" is used herein, it is to be understood that reference is made only to so much of the depreciation as was in excess of the proper amount and did not serve to reduce taxable income.

Under the unanimous decision of this Court in the *Dobson* case, this determination by the Tax Court in the case at bar was final and should not have been disturbed by the Circuit Court of Appeals.

(1) On the issue as to whether the Circuit Court of Appeals should consider the determination of the Tax Court binding, there is no sound basis upon which this case can be distinguished from the *Dobson* case. The *very same* section of the Code is involved in each, namely, Section 113 (b)(1) which, so far as here material, reads:

> "SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS."
>
> * * * * * * *
>
> (b) *Adjusted Basis.* The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.
>
> (1) General Rule. Proper adjustment in respect of the property shall in all cases be made—
>
> (A) For expenditures, receipts, losses, or other items, properly chargeable to capital account, * * *;
>
> (B) * * * for exhaustion, wear and tear, obsolescence, amortization and depletion, to the extent allowed * * *;

In the *Dobson* case, this Court held that the question as to what was a "proper adjustment" under (A) of the section was the character of question on which the Tax Court's determination was final. Obviously, the question as to what was a "proper adjustment" under (B) of the section is a question of the same character on which the Tax Court's determination should also be final. This Court unanimously concluded in the *Dobson* case that the Circuit Court of Appeals erred in substituting its judgment for that of the Tax Court. It clearly follows that the Court below in the case at bar also erred in reversing the Tax Court on this issue.

Let there be no doubt that the *Dobson* situation and the situation in the case at bar involve not only the same section of the law but also involve indistinguishable principles:

(a) In the *Dobson* case, the taxpayer had written off the difference between what he paid for the securities and what he sold them for. In the case at bar, the taxpayer had written off depreciation.

(b) In each case it developed that the amount written off was excessive.

(c) In each case the excessive amount written off and in issue did not reduce taxable income in the year the deduction was reported.

(d) In each case the Tax Court determined that under Section 113 (b)(1), providing for "proper adjustment", no adjustment should be made for the excessive amount reported in prior years where such excessive amounts did not reduce the prior years' taxes.

(e) In each case the Circuit Court of Appeals reversed the Tax Court.

The decision of this Court in the *Dobson* case that the Circuit Court of Appeals should not disturb the determination of the Tax Court in that case requires a similar decision in the case at bar.

(2) This Court's decision in the *Dobson* case establishes that the decision in the *Virginian Hotel* case, upon which the Court below based its decision, does not represent the present view of this Court.

In the *Virginian Hotel* case and in the *Dobson* case the government insisted before this Court that the decisions of the Circuit Courts of Appeals denying the tax benefit rule in bad debt cases were controlling. In the *Virginian Hotel* case the majority of the Court *accepted* the government's argument and relied upon the bad debt cases, citing *Helvering* v. *State-Planters Bank & Trust Co.*, 130 F. (2d)

44 (C. C. A. 4). In the *Dobson* case this Court *rejected* the government's argument and concluded that the bad debt cases had been erroneously decided, stating:

> "It is argued on behalf of the Commissioner that the Court should overrule the Board by applying to this question rules of law laid down in decisions on the analogous problem raised by recovery of bad debts charged off without tax benefit in prior years. The court below accepted the argument. However, instead of affording a reason for overruling the Tax Court, the history of the bad debt recovery question illustrates the mischief of overruling the Tax Court in matters of tax accounting. * * * A specific statutory exception was necessary in bad debt cases *only* because the courts reversed the Tax Court and established as matter of law a 'theoretically proper' rule which distorted the taxpayer's income. Congress would hardly expect the courts *to repeat the same error* in another class of cases, as we would do were we to affirm in this case." (Italics supplied.)

This Court in its decision in the *Dobson* case makes it perfectly clear that the situations in the *Virginian Hotel* and *Dobson* cases are analogous. In its opinion in the *Dobson* case this Court said in footnote 36 (320 U. S. at 506):

> "The question * * * arises not only in cases of recoveries of previously charged off bad debts and recoveries of the type we have here. It is also present in case of * * * adjustments of *depreciation* * * * and other similar situations." (Italics supplied.)

Since it is conceded that the question involved in the *Dobson* case and the question involved in the *Virginian Hotel* case are analogous to the question involved in the bad debt cases, it is certainly most incongruous to find absolutely opposite results. The only explanation is that the *Dobson* case is not only authority for the proposition that the bad debt cases were erroneously decided but is equally authority for the proposition that the depreciation cases—*Virginian Hotel* type cases—were erroneously decided.

The clear conflict between the *Virginian Hotel* and *Dobson* decisions of this Court has caused much uncertainty and confusion in the tax law which has not been moderated by this Court's decision in the *Douglas* case decided even more recently. In the *Douglas* case the same principle was involved in connection with depletion, but was involved as a secondary contention. Since the Court divided on the primary contention, and since one Justice did not participate and two other Justices apparently did not pass on the secondary question, the result has increased the confusion.

We respectfully submit that a most unusual state of conflict and confusion exists to which this Court should put an end at the earliest possible moment by granting the petition herein and reviewing this question.

Respectfully submitted,

F. G. Davidson, Jr.,
Theodore L. Harrison,
J. Donald Rawlings,
W. A. Sutherland,
Amici Curiae.

October, 1944.